Alphinity Global Equity Fund

Monthly Report October 2021

Performance[1]	Quarter %	6 months %	1 year %	3 years % p.a	5 years % p.a	Inception % p.a[2]
Fund return (net)	2.8	18.7	40.2	20.2	19.7	15.3
MSCI World Net Total Return Index (AUD)[3]	1.6	11.9	31.3	15.9	15.8	13.1
Excess return[4]	1.2	6.8	8.9	4.2	3.9	2.2

Fund facts	
Portfolio managers	Jonas Palmqvist, Jeff Thomson, Nikki Thomas, Trent Masters, Mary Manning
APIR code	HOW0164AU
Inception date	21 December 2015
Investment objective	To outperform the MSCI World Net Index (AUD).
Management fee	1.00% p.a.
Performance fee	10% of the excess return of the Fund above the Performance Benchmark (MSCI World Net Return Index (AUD)) and only paid if performance is above the Performance Hurdle (Reserve Bank of Australia cash rate target). Any negative or unpaid performance is carried forward to the next period.[1]
Buy/sell spread	+0.25% / -0.25%
Fund size	$199m
Distributions	Annually at 30 June
Min. Investment	$10,000
Max. cash position	20%

Top 10 positions

Company	Sector	%
Microsoft Corp	Info. Technology	6.2
Alphabet	Comm. Services	5.9
Bank of America Corp	Financials Ex Prop	5.1
Apple	Info. Technology	4.9
Danaher Corp	Health Care	4.2
Morgan Stanley	Financials Ex Prop	4.0
ASML Holding NV	Info. Technology	4.0
Target Corp	Consumer Disc.	4.0
UnitedHealth Group	Health Care	4.0
Prologis	Real Estate	3.9
Total		**46.2**

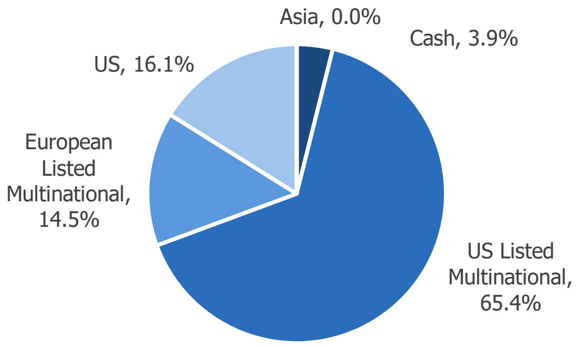
Data Source: Fidante Partners Limited, 31 October 2021

[1] Returns are calculated after fees have been deducted and assume distributions have been reinvested. No allowance is made for tax when calculating these figures.

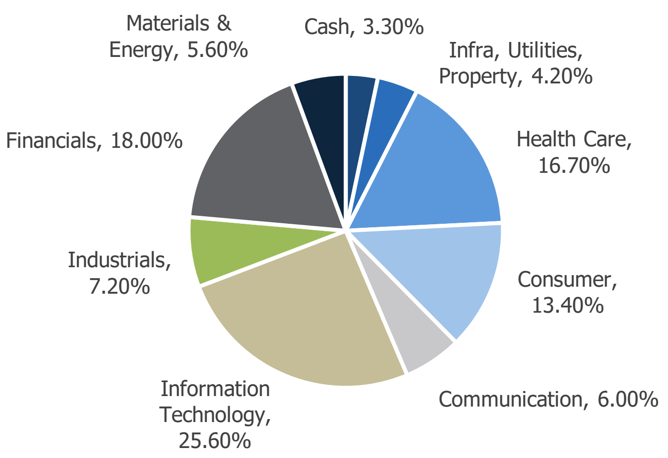
[2] The inception date for the Fund is 21 December 2015

Fund features
Concentrated: A long only, concentrated portfolio of 25-40 of our best ideas, highly diversified across sectors and regions. A truly global fund consistently exposed to powerful trends reshaping our world.
Discipline: A disciplined process finding quality businesses with strong earnings that are under appreciated by the market. This approach has proven successful across different market cycles.
Talent: A united and deeply experienced team of global portfolio managers each with over 20 years in the industry.
Aligned: Alphinity Investment Management is a boutique firm, strongly aligned with its clients' investment objectives and focused solely on growing clients' wealth.

Geographical exposure



Sector exposure



[3] From 21 December 2015 to 31 March 2019, the Benchmark was the MSCI World Equity ex Australia (Net) Index. The current index is effective from 1 April 2019.

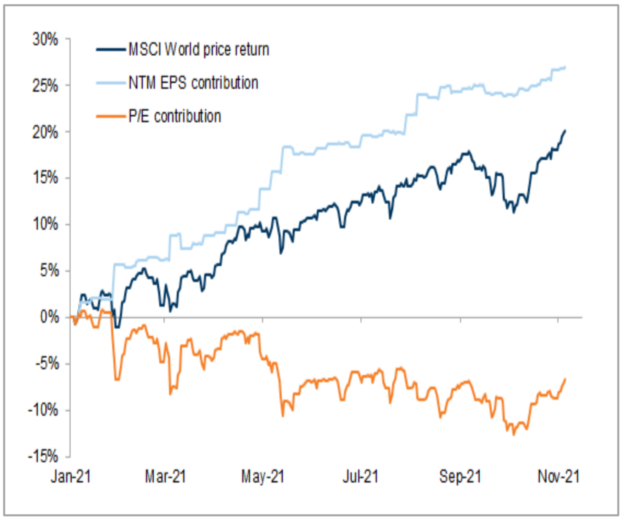
[4] Numbers may not add due to rounding

Market overview

Global equity markets resumed their 2021 rally in October, with the MSCI World Index (AUD) up 1.4%, although the headline move masked a wide divergence between stronger developed markets and weaker emerging market performance. Equities withstood a rise in bond yields, particularly in shorter dated maturities, as the market seemingly priced in U.S. bond tapering and the gradual withdrawal of central bank liquidity.

While earnings have been the main driver of returns for most of 2021, the current leg of the rally has been largely driven by rising valuations. Higher valuations might become a speed limit for returns over the long term, but near term low real rates coupled with ongoing strong flows into equities help explain the continued rerating witnessed in global Equities.

Recent MSCI World equity returns driven by multiple expansions



Source: Goldman Sachs, FactSet, Bloomberg

U.S. stocks (S&P 500 +2.8%) drove global performance, while Brazil (-13.4%) Korea (-6.3%) and China A shares (-3.9%) dragged emerging markets lower for various reasons including political instability, rising inflation and some further Covid outbreaks in parts of Asia.

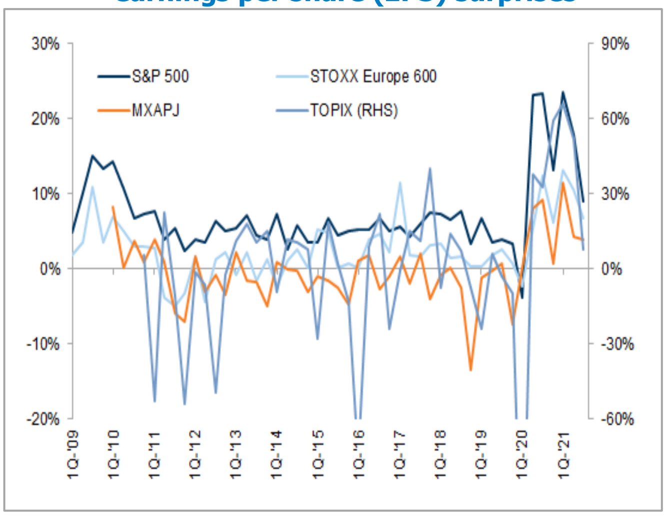
Economic data was generally supportive of the continued recovery, with good jobs data in the U.S. (non-farm payrolls +531k vs expectations of 450k) and expanding global services and manufacturing purchasing managers indices (PMIs) helping to offset weaker industrial production and manufacturing PMI in China, where supply side reforms continue to dampen growth.

U.S. 10-year bond yields rose 4 bps to 1.55%, although the biggest moves were seen in shorter dated bonds, most notably in Australia where 3-year yields rose 91bps to 1.22% as the RBA effectively abandoned yield curve control. Crude oil rose 11% to USD84/bbl, while iron ore lost another 8% to USD110/t.

Cyclical and growth leadership continued with Consumer Discretionary, Energy and Technology stocks leading market performance, while more defensive sectors including Healthcare and Consumer Staples lagged. Communication Services was the weakest group, despite strong performances from Netflix (+8.6%) and Alphabet (+6.9%). Leading the group lower were Snap (-32%), Pinterest (-16%) and Twitter (-15%) as privacy changes and supply chain outlook reduced ad demand at Snap, and weaker user growth led to a sell-off in Twitter post its earnings release.

Third quarter earnings generally beat expectations at the top and bottom line, with positive revisions to 2021 consensus over the last four weeks highest in Energy (+7.1%) and Financials (+3.3%), while Consumer Discretionary (-1.7%) was the weakest. Despite supply chain disruptions and cost inflation, companies mostly managed to successfully navigate margin pressures through pricing, although margin headwinds will mostly persist into 2022.

3Q Earnings season delivered above-average earnings per share (EPS) surprises



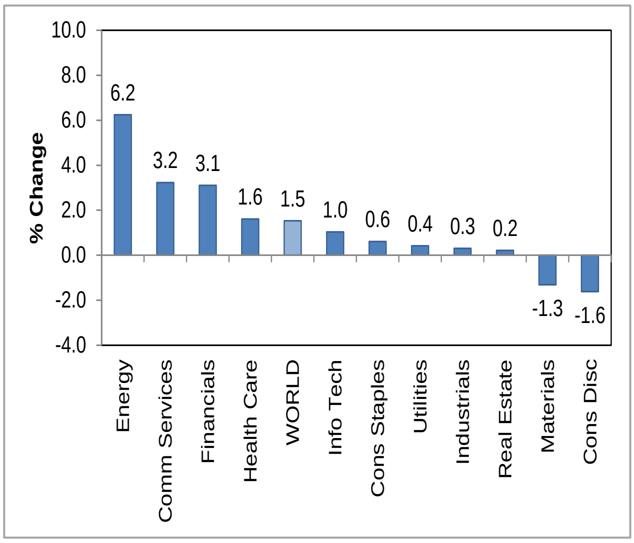
Source: Goldman Sachs, FactSet, Bloomberg

Portfolio comment and outlook

Global growth is likely to remain above trend as we enter 2022, however momentum appears to have already peaked, and is set to slow in several major economies including the U.S. and China. With equity markets rising to historically high valuation multiples, validation from earnings is increasingly important for the overall market.

The third quarter reporting season was supportive, with analyst forecasts for 2022 global earnings rising another +1.5% during October. However, the upgrade cycle is losing some of its breadth, with not all sectors and companies participating as strongly as before. The relative earnings leadership still sits with cyclical and growth companies, but some early cyclical sectors such as Consumer Discretionary, Materials and Industrials have recently weakened.

Earnings surprises have rolled over but Global Earnings Revisions still at historic highs



Source: Alphinity, Bloomberg, 1 November 2021

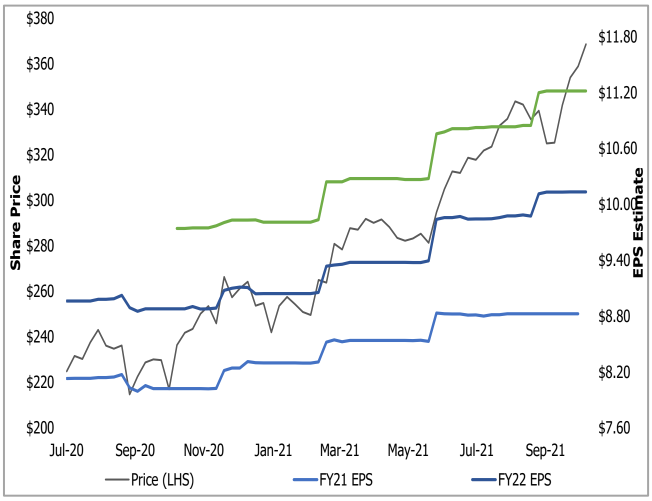
While we have largely maintained our portfolio bias to growth and cyclical stocks, we have continued to make some changes to reflect the maturing cycle and rising valuations. At the margin, the portfolio is slightly less cyclical today compared to a few months ago.

In October, we exited positions in homebuilder PulteGroup, auto manufacturer Volvo and payments financial play Visa, having lost conviction in the earnings outlooks. We also trimmed positions including Trane Technologies, Otis Elevators and Alphabet after strong performance. We added new positions in high quality, growth stocks Accenture, a global management consulting firm, Netflix and global health care provider Merck.

Strong reports from Microsoft, LVMH and Universal Music led us to increase our positions. Nestle also reported another good quarter, and we added to our holding in the stock, although overall we remain relatively less invested in defensives as many of those companies are still laggards in the earnings cycle.

With economic growth and monetary stimulus peaking, the earnings cycle maturing, and valuations high, investment risks appear to be rising. We intend to keep an open mind about the outlook, with a strong bench of stocks for different growth and market outcomes. We will continue to let earnings leadership, on a stock by stock basis, guide us through the cycle.

Accenture (ACN) – Leading global professional services company – Enjoying ongoing strong earnings upgrades



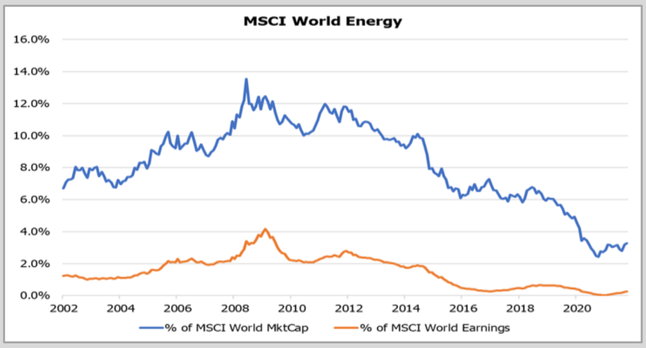
Source: Alphinity, Bloomberg, 1 November 2021

What's on our mind - Global Energy stocks: Timing the ping-pong ball bouncing down the stairs

Market continues to assign less relative importance to big energy plays. The focus on climate action and de-carbonisation is increasing and will continue to have a big impact on everything from policy making to investment decisions for years to come. Even though the actual shift of society to more sustainable energy sources will be a multi-decade story, global equity markets (as always) has its tentacles out into the future.

The Energy sector in the global MSCI World Index, has shrunk from 12% to 3% since the GFC, despite containing huge businesses such as ExxonMobil, BP, Total and Chevron. It has been a consistent under-performer in global equities since then, with the market clearly assigning less and less relative importance to them. Unsurprisingly, the performance mirrors the fact that energy companies also have a diminishing share of global earnings as reflected in the chart below.

MSCI World Energy Market Cap & Earnings declining vs overall index



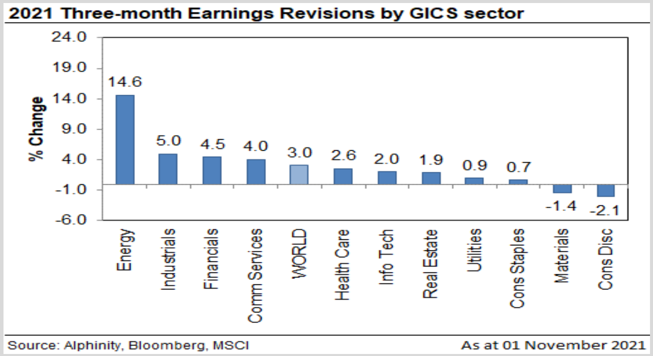
Source: Macquarie

Does this mean Energy is a sector to completely disregard from here? Certainly not, as we should always try to keep an open mind about the future. Importantly, traditional energy companies are waking up to the shifting future, trying to turn their considerable investment capacities towards renewable energy sources. This drive to adjust to the future partly comes from within the companies, but there is also pressure building from both world-class activist investors, as well as court action by governments and environmentalist shareholders. Or, perhaps more likely, at least split up in 'sustainable' vs 'carbon' companies.

Timing the energy earnings cycle is the tricky part

Energy companies' earnings cycles are driven by oil and gas prices. There are periods when these stocks see big earnings upgrades and participate in the global earnings leadership. 2021 has been one such period, with the oil price rising from \$50 to \$85/barrel, driving strong earnings upgrades.

Energy enjoying big earnings upgrades in 2021



Beyond these occasional earnings rotations, there are some fundamental challenges around building a lasting, high conviction investment case:

1.The near-term earnings case largely relies on OPEC+'s ability to manage the delicate supply-demand balance of global oil markets. OPEC+ is trying to thread the needle between maximising the value of its oil reserves, and awakening responses from competition and accelerating replacement by renewables.

2.Even as we'll continue to depend on carbon-based energy for decades to come, there's **a continued 'value-trap' risk in the sector.** The ongoing, grinding financial pressure on the valuation of carbon energy assets complicates the investment case. *According to Morgan Stanley, to date around 220 institutional investors representing some \$57tn in assets have committed to align their portfolios with net zero & 88 banks, representing a third of global banking assets, have promised to decarbonise their lending and investment portfolios.* So what is the appropriate long-term valuation multiple for 'carbon assets', especially as they are increasingly seen as eventually 'stranded'?

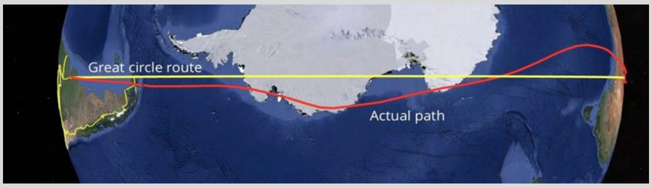
In summary, since the world started shifting its focus to renewable options, the global energy sector as an investment opportunity has been behaving like that proverbial ping-pong ball bouncing down the stairs: a consistent under-performance, with occasional rallies and recoveries. Whoever can time the up-bounces well can make additional investment returns, but the staircase itself is still heading in the opposite direction – down. We can't rule out investing in the 'old guard' of energy stocks again at some point, but their market significance is falling, and the fundamental hurdles seem to be rising.

Traveller's Tale

The opening up of Australia to travellers is welcome news for many Alphinites, considering the wide range of countries from which we come and the number of family members we have in other countries including Sweden, Belgium, Canada, the UK, South Africa, and Russia. With flights out of Sydney now on sale and home quarantine permitted on return, a number of trips have already been booked for the upcoming Christmas break. In these troubled times of course you can never completely rely on actually getting out should things go awry at the last moment, and getting back in might also turn out to be a bit of a lottery. But it's a start.

Repatriation flights are still taking place though, and a notable one took place in October when Qantas flew one of its 787 Dreamliners non-stop from Buenos Aires in Argentina to Darwin carrying 107 passengers headed for the Howard Springs holiday camp, plus 21 crew. It was the longest commercial flight ever undertaken by the airline, a total of 15,037 km in 17½ hours as shown in the map (courtesy of Flightradar24.com) below.

Why did it take such an odd route, essentially a big U-turn? Surely they know that the shortest distance between two points is a straight line? Well, despite appearances it <u>was</u> almost a straight line, it is just the distorting projection of the map that makes it look so odd. On a sphere, as shown below, the route looks more sensible. It is almost straight, with only a few deviations required to avoid bad weather and to ameliorate some of the risks involved in flying over that part of the world in a two-engine aircraft.



The flight took off from Buenos Aires with 126,000 litres of fuel and reached an altitude of 40,000 feet (~12km) at its peak. According to a tweet from the cockpit half way into the trip, the outside air temperature was -75 degrees Celsius.

Prior to this month, Qantas' longest commercial flight was London-Perth at 14,499 km. It has done a few longer legs but they were not for paying passengers. One was in 2019 when it was testing non-stop flights New York to Sydney for "Project Sunrise": 16,013km in 19½ hours. London to Sydney will be an even more challenging 17,800km! The thought of sitting in a seat – even a comfortable one – for that long isn't all that appealing although we can see that saving a few hours on the way will be compelling for some frequent fliers.

For further information, please contact:

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